



Republic of the Philippines  
Supreme Court  
Manila

FIRST DIVISION

MERRIE ANNE TAN,  
Petitioner,

G.R. No. 254510

Present:

-versus-

GESMUNDO, *C.J.*, Chairperson,  
CAGUIOA,  
CARANDANG,  
ZALAMEDA, and  
GAERLAN, *JJ.*

FIRST MALAYAN LEASING  
AND FINANCE CORP., NEW  
UNITEDWARE MARKETING  
CORP., and EDWARD YAO,  
Respondents.

Promulgated:

JUN 16 2021

x ----- x

DECISION

CAGUIOA, *J.*:

This is a Petition for Review on Certiorari<sup>1</sup> (Petition) under Rule 45 which seeks a reversal of the October 30, 2019 Decision<sup>2</sup> and the November 24, 2020 Resolution<sup>3</sup> of the Court of Appeals Former Special Fourth Division (CA) in CA-G.R. CV No. 110069, and prays for the following reliefs:

WHEREFORE, it is most respectfully prayed of the Honorable Supreme Court that:

1. Instant petition, primarily a plea and cry for true justice, be given due course;
2. The Decision dated October 30, 2019 and Resolution dated November 24, 2020 of the Court of Appeals in CA-GR CV No. 110069 be reversed and set aside;

<sup>1</sup> *Rollo*, pp. 11-34.

<sup>2</sup> *Id.* at 39-54. Penned by Associate Justice Gabriel T. Robeniol, with Associate Justices Ramon A. Cruz and Jhosep Y. Lopez (now a Member of the Court) concurring.

<sup>3</sup> *Id.* at 56-57.

3. A new decision be rendered as follows:

3.1. Ordering respondent Yao to pay the entire claim of the respondent (plaintiff-appellee) [FMLFC];

3.2. Deleting the award for penalty of 12% per annum starting November 17, 2004 until full payment and the 10% percent attorney's fees;

3.3. Ordering respondent Yao to pay damages and attorney's fees to respondent NUMC and the petitioner and her husband;

Granting unto petitioner such other reliefs just and equitable under the premises.<sup>4</sup>

### *Facts*

The factual backdrop of the instant controversy is straightforward, and involves the primary issue of the status and nature of the obligation of the remaining multi-party surety on a defaulted loan payment, upon the release of one of the sureties.

On December 8, 2000, respondent New Unitedware Marketing Corporation (NUMC) obtained a loan from respondent First Malayan Leasing and Finance Corporation (FMLFC) in the amount of ₱5,000,000.00, as evidenced by the terms of the Promissory Note executed on even date. The loan was later refinanced on various dates at the instance of NUMC.<sup>5</sup> As security for the loan, NUMC executed a Deed of Assignment on July 2, 2001 in favor of FMLFC, covering NUMC's fire insurance claim proceeds from Philippine Charter Insurance Corporation (PCIC). Furthermore, as additional security, petitioner Merrie Anne L. Tan (Merrie Tan), who was a member of NUMC's Board of Directors, and Edward Yao (Yao), as President and General Manager of NUMC,<sup>6</sup> executed a "Continuing Surety Undertaking" on July 27, 2001 in favor of FMLFC. More, on November 29, 2002, one Samson Ding (Ding), also a member of NUMC's Board of Directors, and Merrie Tan's spouse, Willy Tan (now deceased) likewise executed a second Continuing Surety Undertaking in favor of FMLFC.

When NUMC defaulted on its payment of the loan, FMLFC declared that as of November 17, 2004, NUMC owed it the remaining balance of ₱2,942,822.36 due, exclusive of 5% penalty charges and interests.<sup>7</sup> When FMLFC's demands on NUMC, as well as on Yao, Ding and Spouses Merrie and Willy Tan (Spouses Tan) went unheeded, it filed a Complaint for Sum of Money and Damages with Prayer for Preliminary Attachment on January 3, 2005 against NUMC, Ding and Spouses Tan before Branch 62, Regional Trial Court, Makati City (RTC) docketed as Civil Case No. 04-1384.<sup>8</sup>

<sup>4</sup> Id. at 33-34.

<sup>5</sup> Id. at 40.

<sup>6</sup> Id. at 19.

<sup>7</sup> Id. at 41.

<sup>8</sup> Id. at 16.



Then on October 21, 2005, during the pendency of the proceedings before the RTC, Merrie Tan discovered that Ding, in behalf of another corporation, and Yao, in behalf of NUMC, had entered into a Compromise Agreement with PCIC, where Ding and Yao were paid the amounts of ₱55,570,930.92 and ₱75,867,556.73, respectively, as payments for the fire insurance policy claim, the proceeds of which were earlier assigned by NUMC in favor of FMLFC.<sup>9</sup>

Premised on the said Compromise Agreement, Merrie Tan argued that Ding and Yao should be made exclusively liable for FMLFC's claim since they were the ones who received the proceeds from the fire insurance claim, which was intended to pay for the outstanding loan obligation of NUMC to FMLFC.<sup>10</sup>

Yao, for his part, denied that he received the proceeds of the fire insurance claim from PCIC, and contended that the indemnity checks which PCIC paid were merely endorsed by him in his official capacity to the bank for encashment, but that the proceeds of the checks were delivered by the bank to Ding and Willy Tan. Yao finally added that he already settled with FMLFC his share of NUMC's obligation when he paid FMLFC the amount of ₱980,000.00, in exchange of which the latter executed a "Receipt and Release" in his favor.<sup>11</sup>

### *RTC Ruling*

On February 9, 2017, the RTC rendered its Decision which ruled for FMLFC, with its dispositive portion reading thus:

WHEREFORE, judgment is hereby rendered in favor [of] plaintiff FIRST MALAYAN LEASING AND FINANCE CORPORATION ordering the defendants NEW UNITEDWARE MARKETING CORPORATION, MERRIE ANNE L. TAN, SING JIAN ZI aka SAMSON DING and CHEN YI MING aka WILLY TAN to pay the former, jointly and solidarily, the following:

1. Two Million Nine Hundred Forty-Two Thousand Eight Hundred Twenty-Two & Thirty-Six Centavos (Php2,942,822.36) Philippine currency plus interest at the legal rate of six (6%) percent per annum as well as penalty charge at the rate of twelve (12%) percent per annum reckoning from November 17, 2004 until fully paid;
2. Amount equivalent to ten (10%) percent of the total amount due as liquidated damages;
3. Amount equivalent to ten (10%) percent of the total amount due as and for attorney's fees; and

<sup>9</sup> Id. at 41-42.

<sup>10</sup> Id. at 42.

<sup>11</sup> Id.

4. Costs of litigation.

The Third-Party Complaint filed by Merrie Anne Tan and Willy Tan is hereby DISMISSED.

SO ORDERED.<sup>12</sup>

In ruling in favor of FMLFC, the RTC held that Spouses Tan, Ding and Yao are indeed solidarily liable under the “Continuing Surety Undertaking” each had executed, and that Yao’s release as executed by FMLFC did not operate to absolve Spouses Tan and Ding as co-sureties from their solidary liability on the loan obligation of NUMC. It held that Yao’s release only extinguished FMLFC’s claim against him, but did not affect the former’s claim against the co-sureties.<sup>13</sup> It also rejected Merrie Tan’s third-party claim that Yao should be held to account for the insurance proceeds from PCIC, as the same was not included in FMLFC’s claim against them and that the docket fees for said complaint were not paid.<sup>14</sup> The RTC, however, adjusted the rates of stipulated interests which it found iniquitous and unconscionable.

Spouses Tan filed an Omnibus Motion for New Trial/Reconsideration on June 28, 2017, which was similarly denied by the RTC through its Order dated September 5, 2017.<sup>15</sup> Spouses Tan thereafter appealed to the CA, with the same docketed as CA-G.R. CV No. 110069.

### *CA Ruling*

The CA denied Spouses Tan’s appeal through its Decision dated October 30, 2019, which dispositively read:

**WHEREFORE**, the appeal is DENIED. The *Decision* dated February 9, 2017 and *Order* dated October 6, 2017 of the Regional Trial Court of Makati City, Branch 62, in Civil Case No. 04-1384, are hereby **AFFIRMED with the MODIFICATIONS** that:

- (1) the interest rate is reduced to twelve percent (12%) *per annum* from November 17, 2004 until June 30, 2013 and six percent (6%) *per annum* from July 1, 2013 until the finality of this decision;
- (2) the penalty charge imposed is reduced to six percent (6%) *per annum* reckoned from November 14, 2004; and
- (3) the total judgment award shall be subject to interest at the rate of six percent (6%) *per annum* from the finality of this *Decision* until its full satisfaction.

The rest of the RTC’s *Decision* stands.

---

<sup>12</sup> Id. at 18.

<sup>13</sup> Id. at 43.

<sup>14</sup> Id.

<sup>15</sup> Id.



**SO ORDERED.**<sup>16</sup>

Therein, the CA found that: (i) the release of Yao as co-surety did not extinguish the remaining co-sureties' solidary liability;<sup>17</sup> (ii) the simultaneous imposition of penalty charges, liquidated damages and attorney's fees is proper but the reduction of the said rates is warranted;<sup>18</sup> and (iii) the third-party complaint filed by Spouses Tan against Yao was correctly dismissed since no docket fees were paid therefor.<sup>19</sup>

First, the CA ruled that contrary to Merrie Tan's claim that the release of Yao as surety effectively novated the solidary obligation to a divisible one, the release of Yao only had the effect of a modificatory novation, since FMLFC nevertheless retained its right to pursue the old obligation on the remaining sureties.<sup>20</sup> It held that the loan balance over which the remaining sureties were solidarily liable was only reduced from ₱3,429,813.58 to ₱2,942,822.36, upon the deduction of Yao's payment of ₱980,000.00.<sup>21</sup>

Second, it found that the Promissory Note stipulated two penalty clauses: (i) the late payment charge of 5% per month, and (ii) 25% of the total amount due for attorney's fees and 25% of the total amount due as liquidated damages. The CA reasoned that the late payment charge, liquidated damages and attorney's fees constitute free and voluntary stipulations which are well-within the parties' prerogative to secure performance and discourage breach.<sup>22</sup> It added that there was nothing improper in the stipulation of attorney's fees since they are similarly imposed as a penalty for breach of an obligation.<sup>23</sup>

Third, the CA held that the dismissal of Spouses Tan's third-party complaint was merited for their failure to pay the docket fees. It reminded that the payment of docket fees is a positive duty that the law imposes upon the third-party plaintiff, and Spouses Tan may not blame the RTC for its own admitted omission.<sup>24</sup>

Spouses Tan sought a reconsideration of the CA's Decision, pending the resolution of which, Willy Tan died of COVID-19 on July 21, 2020.<sup>25</sup> When the CA denied their Motion for Reconsideration in its Resolution dated November 24, 2020, Merrie Tan resorted to this Court *via* the instant Petition.

In the instant Petition, Merrie Tan submits that the CA erred in holding that her solidary obligation along with Ding and her husband, Willy Tan was not novated to a divisible obligation by virtue of FMLFC's release of Yao

---

<sup>16</sup> Id. at 53.

<sup>17</sup> Id. at 46-48.

<sup>18</sup> Id. at 48-51.

<sup>19</sup> Id. at 51-52.

<sup>20</sup> Id. at 48.

<sup>21</sup> Id.

<sup>22</sup> Id. at 50.

<sup>23</sup> Id.

<sup>24</sup> Id. at 52.

<sup>25</sup> See Certificate of Death, id. at 58.



upon the latter's payment of his share alone.<sup>26</sup> She likewise argues that the CA erred in ordering the payment of the rate of 6% *per annum* legal interest and the rate of 12% *per annum* penalty charge, and that it also erred in ordering the simultaneous payment of 10% of the total amount for liquidated damages and 10% of the total amount for attorney's fees. Finally, she prays that the Court reverses the CA's affirmation of the RTC's dismissal of her third-party complaint against Yao.<sup>27</sup>

Merrie Tan first argues that when FMLFC released Yao from the solidary surety obligation upon the latter's partial payment of the entire loan obligation, it effectively converted the solidary obligation to a divisible one, where the co-sureties are no longer liable for the whole obligation but only for their respective shares therein.<sup>28</sup> She avers that otherwise, it would be the height of injustice if Yao was only held liable for the amount of ₱980,000.00 while respondent NUMC, Ding and herself are still held liable for the total outstanding loan obligation of ₱2,942,822.36. She adds that FMLFC is already estopped from claiming that the obligation of the sureties is still solidary, when it already accepted Yao's partial payment and released him by virtue of the same, with Yao's payment effectively being far below the amount of the total loan obligation.<sup>29</sup>

On the matter of the simultaneous imposition of penalty and liquidated damages, she avers that since both are of a similar nature, the award of one precludes the award of the other.<sup>30</sup>

With respect to the dismissal of her third-party complaint against Yao, Merrie Tan submits that instead of dismissing her complaint, the RTC should have instead ordered her and her husband to pay the docket fee pursuant to Section 7, Rule 141 of the Rules of Court.<sup>31</sup>

Finally, with respect to Yao's liability, Merrie Tan maintains that as a signatory to the Deed of Assignment of the fire insurance claim proceeds, Yao is primarily liable to ensure that the claim of FMLFC is settled through the payment of NUMC's fire insurance claim proceeds. She asserts that Yao's failure to ensure payment of said claim by FMLFC indicates gross negligence and breach of duties and obligations of Yao as the President and General Manager of NUMC.<sup>32</sup> She adds that NUMC was not made aware of the settlement with PCIC, and that the same was only discovered when FMLFC filed a garnishment case against PCIC, and PCIC intimated that it had already earlier paid NUMC's claim in full through Yao.<sup>33</sup>

---

<sup>26</sup> Id. at 20.

<sup>27</sup> Id. at 21.

<sup>28</sup> Id. at 21-22.

<sup>29</sup> Id.

<sup>30</sup> Id. at 26.

<sup>31</sup> Id. at 28. Merrie Tan erroneously stated Rule 140 in the Petition.

<sup>32</sup> Id. at 30-31.

<sup>33</sup> Id. at 32.



### *Issue*

The threshold issue for the Court's resolution is whether the CA erred in affirming the RTC in the following findings: (i) the solidary obligation insofar as Spouses Tan and Ding were concerned was not novated by FMLFC's release of Yao; (ii) the penalty charges, liquidated damages and attorney's fees were properly imposed; and (iii) the third-party complaint of Spouses Tan against Yao was correctly dismissed.

### *The Court's Ruling*

The Court finds the Petition partly meritorious.

Specifically, the Court rules that the CA correctly held that the obligation of the Spouses Tan and Ding remain solidary despite the release of Yao from the same, but it erred in affirming the RTC's simultaneous imposition of the penalty charge and the liquidated damages, its imposed rate of attorney's fees, and its dismissal of Merrie Tan's third-party complaint against Yao with prejudice.

Preliminarily, the Court notes the importance of the autonomous characteristic of contracts, pursuant to which the parties are free to establish such stipulations, clauses and other terms and conditions as they may agree upon to be convenient, with the only parameter that they are not contrary to law, morals, good customs, public order or public policy.<sup>34</sup> It is further remembered that when the terms of an agreement have been reduced to writing, it is considered as containing all the terms agreed upon and there can be no evidence on such terms other than the contents of the written agreement.<sup>35</sup> Finally, when the terms of the contract are clear and leave no doubt upon the intention of the contracting parties, the stipulations of the parties are controlling.<sup>36</sup>

These principles bear upon the merits of the instant Petition, specifically on the Continuing Surety Undertaking which Merrie Tan executed in favor of FMLFC, and the Receipt and Release executed by FMLFC in favor of Yao.

In the main, the Court recalls the essentially solidary nature and the extent of a surety's liability. Article 2047 of the Civil Code provides with clarity:

ARTICLE 2047. By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.

<sup>34</sup> *Industrial Personnel and Management Services, Inc. v. Country Bankers Insurance Corp.*, G.R. No. 194126, October 17, 2018 883 SCRA, 404, 415, citing CIVIL CODE, Art. 1306.

<sup>35</sup> RULES OF COURT, Rule 130, Sec. 9.

<sup>36</sup> CIVIL CODE, Art. 1370.



If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship.

The above statutory definition of a suretyship provides that in a surety agreement, the surety undertakes to be bound solidarily with the principal debtor, with their liabilities so interwoven as to be inseparable. Accordingly, Articles 1207 up to 1222 of the Civil Code on joint and solidary obligations govern suretyship.

In *Philippine Charter Insurance Corporation v. Petroleum Distributors & Service Corporation*,<sup>37</sup> the Court fleshed out the operation of a suretyship undertaking in this wise:

A contract of suretyship is an agreement whereby a party, called the surety, guarantees the performance by another party, called the principal or obligor, of an obligation or undertaking in favor of another party, called the obligee. Although the contract of a surety is secondary only to a valid principal obligation, the surety becomes liable for the debt or duty of another although it possesses no direct or personal interest over the obligations nor does it receive any benefit therefrom. This was explained in the case of *Stronghold Insurance Company, Inc. v. Republic-Asahi Glass Corporation*, where it was written:

The surety's obligation is not an original and direct one for the performance of his own act, but merely accessory or collateral to the obligation contracted by the principal. Nevertheless, **although the contract of a surety is in essence secondary only to a valid principal obligation, his liability to the creditor or promisee of the principal is said to be direct, primary and absolute; in other words, he is directly and equally bound with the principal.**

x x x x

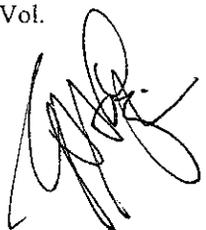
Thus, suretyship arises upon the solidary binding of a person deemed the surety with the principal debtor for the purpose of fulfilling an obligation. **A surety is considered in law as being the same party as the debtor in relation to whatever is adjudged touching the obligation of the latter, and their liabilities are interwoven as to be inseparable.**<sup>38</sup>

It has also been noted by eminent civilist former CA Justice Eduardo P. Caguioa that although the suretyship itself is a contract that is ancillary to the main financial accommodation contract between the principal and the creditor, what sets the surety apart from a mere guaranty is that in a suretyship, the surety is principally liable, as opposed to a guarantor who is only secondarily liable.<sup>39</sup> So much so that with a suretyship agreement securing the loan transaction, a creditor may go directly against the surety even without a prior demand on the principal debtor, although the latter may be solvent or

<sup>37</sup> 686 Phil. 154 (2012).

<sup>38</sup> Id. at 166-167. Emphasis supplied.

<sup>39</sup> EDUARDO P. CAGUIOA, COMMENTS AND CASES ON CIVIL LAW CIVIL CODE OF THE PHILIPPINES, Vol. VI (First ed. 1970), p. 306.



otherwise able to pay.<sup>40</sup> A surety's liability stands irrespective of the principal debtor's ability to perform his obligations under the contract which is subject of the suretyship.<sup>41</sup>

In the instant controversy, Merrie Tan, along with Yao executed a "Continuing Surety Undertaking," which has been described in *Lim v. Security Bank Corp.*<sup>42</sup> as a continuing suretyship:

Comprehensive or continuing surety agreements are, in fact, quite commonplace in present day financial and commercial practice. A bank or financing company which anticipates entering into a series of credit transactions with a particular company, normally requires the projected principal debtor to execute a continuing surety agreement along with its sureties. By executing such an agreement, the principal places itself in a position to enter into the projected series of transactions with its creditor; with such suretyship agreement, there would be no need to execute a separate surety contract or bond for each financing or credit accommodation extended to the principal debtor.<sup>43</sup>

Continuing suretyships have been observed by the Court to be usual in the commercial practice, where the principal places itself in a position to enter into projected series of transactions with its creditor, with no more need to execute a separate surety contract for each financial accommodation, since the continuing suretyship covers the subsequent ones as well.<sup>44</sup> These continuing suretyships have the effect of encouraging the creditor to extend further accommodations without the fears and uncertainties that unsecured credits carry.

Under the "Continuing Surety Undertaking" of the instant case, FMLFC may seek to recover from NUMC, or from Merrie Tan or Ding, consistent with Article 1216 of the Civil Code which provides:

Article 1216. The **creditor may proceed against any one of the solidary debtors or some or all of them simultaneously**. The demand made against one of them shall not be an obstacle to those which may subsequently be directed against the others, so long as the debt has not been fully collected. (Emphasis supplied)

In fact, the Receipt and Release executed by FMLFC in favor of Yao categorically provides for the reservation of its option to proceed against the remaining co-sureties Spouses Tan and Ding, to wit:

Subject to the condition precedent that the above-mentioned check shall be duly honored by the drawee bank upon presentment and in consideration of said payment, Malayan Leasing agrees to (a) release Mr. Yao from his obligations as such surety, and (b) not to file any case or action

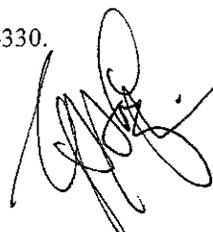
<sup>40</sup> *Trade and Investment Development Corporation of the Philippines v. Philippine Veterans Bank*, G.R. No. 233850, July 1, 2019, 907 SCRA 66, 81.

<sup>41</sup> *The Mercantile Insurance Co., Inc. v. DMCI-Laing Construction, Inc.*, G.R. No. 205007, September 16, 2019, accessed at <<https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/1/65762>>.

<sup>42</sup> 729 Phil. 345 (2014).

<sup>43</sup> Id. at 352-353.

<sup>44</sup> *Totanes v. China Banking Corporation*, G.R. No. 179880, January 19, 2009, 576 SCRA 323, 329-330.



against Mr. Yao, whether civil, criminal or otherwise, arising under or in connection with the remaining obligations of New Unitedware under the above-mentioned Promissory Note and related documents.

**This is without prejudice to the right of Malayan Leasing to exercise any and all rights and remedies which it may have, either by contract or under applicable law, against New Unitedware, and/or its officers, directors, stockholders and/or sureties (excluding Mr. Yao).<sup>45</sup>**

Clearly, as spelled out in the Receipt and Release, and consistent with its right as a creditor of solidary obligors under Article 1216, FMLFC proceeded against Yao, later released him from the suretyship upon payment of ₱980,000.00, and expressly reserved its right to proceed against NUMC and/or its remaining co-sureties.

Therefore, Merrie Tan's submissions that (i) FMLFC is estopped from treating her and the remaining co-sureties as solidary obligors since it accepted partial payment of NUMC's outstanding loan obligation from Yao; and (ii) that said acceptance and subsequent release amounted to a novation which converted the suretyship into a divisible obligation are both misplaced.

On the contrary, FMLFC was well within its rights as a creditor to proceed against either NUMC or any one or more or all of the co-sureties for the collection of NUMC's outstanding loan. That it chose to first proceed against Yao and not against the other co-sureties did not operate as an estoppel on it from subsequently proceeding against the remaining co-sureties. More, that it agreed to release Yao upon the latter's payment of a partial amount of the total loan obligation of NUMC also did not operate to bar it from proceeding against the remaining co-sureties to ensure the full satisfaction of the debt. The liability of Merrie Tan remains solidary with NUMC, regardless of partial payment by Yao, precisely because the kind of security she undertook was one of suretyship. However, as the CA correctly determined, the outstanding loan obligation for which Merrie Tan, NUMC and Ding remain solidarily liable for has been effectively reduced by Yao's partial satisfaction of the same.

To be sure, the Court has so far acknowledged instances when a surety is discharged from liability as a result of an act or omission of the creditor that may be declared negligent or otherwise constitutive of a material alteration of the contract.<sup>46</sup> In *Philippine National Bank v. Manila Surety & Fidelity Co., Inc.*,<sup>47</sup> the surety was considered released since the creditor therein was found negligent in allowing the assigned funds to be exhausted without notifying the surety, thereby depriving the latter of any possibility of availing of a recourse against that security. Similarly, in the case of *Philippine National Bank v. Luzon Surety Co., Inc.*,<sup>48</sup> the Court recognized that material alteration can be

<sup>45</sup> *Rollo*, pp. 47-48. Emphasis supplied.

<sup>46</sup> See *Carodan v. China Banking Corporation*, 781 Phil. 750, 766 (2016).

<sup>47</sup> 122 Phil. 106 (1965).

<sup>48</sup> G.R. No. L-29587, November 28, 1975, 68 SCRA 207.



a ground for release.<sup>49</sup> In *Palmares v. Court of Appeals*,<sup>50</sup> the Court mentioned that an extension of the time of payment for a definite period without the consent or reservation of the rights of the surety would release the latter.<sup>51</sup>

However, as far as the facts of the suretyship involving Spouses Tan and Ding are concerned, none of the foregoing scenarios obtain. Therefore, contrary to Merrie Tan's chief assertion, they are not released from the solidary obligation to pay FMLFC for NUMC's remaining obligation.

In addition, and most unlike Merrie Tan's submission, these are not the height of injustice, but only the very nature of a suretyship agreement. To be sure, in case Merrie Tan fully pays for NUMC's outstanding obligation to FMLFC, she is not without recourse. For the moment the surety fully answers to the creditor for the obligation created by the principal debtor, such obligation is extinguished. At the same time, the surety may seek reimbursement from the principal debtor for the amount paid, for the surety does in fact become subrogated to all the rights and remedies of the creditor.<sup>52</sup> This remedy of Merrie Tan as against her co-surety Yao is clearly provided for in Article 1217 of the Civil Code, to wit:

Article 1217. Payment made by one of the solidary debtors extinguishes the obligation. If two or more solidary debtors offer to pay, the creditor may choose which offer to accept.

He who made the payment may claim from his co-debtors only the share which corresponds to each, with the interest for the payment already made. If the payment is made before the debt is due, no interest for the intervening period may be demanded.

When one of the solidary debtors cannot, because of his insolvency, reimburse his share to the debtor paying the obligation, such share shall be borne by all his co-debtors, in proportion to the debt of each.

More, the intent of the law to ensure that the obligation of one surety to his co-sureties survives even in the event of a partial or total condonation or remission of the debt owed is likewise clearly provided for in Article 1219 of the Civil Code, which states, *viz.*:

The remission made by the creditor of the share which affects one of the solidary debtors does not release the latter from his responsibility towards the co-debtors, in case the debt had been totally paid by anyone of them before the remission was effected.

With respect to Merrie Tan's submission that the penalty charge, liquidated damages and attorney's fees were improperly imposed, the Court is inclined to agree. The nature of a penalty charge and liquidated damages are similar, and they may not be simultaneously imposed in the instant case

<sup>49</sup> Id. at 214.

<sup>50</sup> G.R. No. 126490, March 31, 1998, 288 SCRA 422.

<sup>51</sup> Id. at 442.

<sup>52</sup> *Escaño, et al. v. Ortigas, Jr.*, G.R. No. 151953, June 29, 2007, 526 SCRA 26, 43.

without violating the fundamental concepts of iniquity and excessiveness, and notwithstanding the contractual autonomy of the parties herein.

To be sure, the characteristic autonomy of the contract as the law between agreeing parties is acknowledged, as exemplified by the Promissory Note executed by NUMC in favor of FMLFC, which provided for the penalty charge, liquidated damages and attorney's fees in order to encourage performance of the obligation and deter nonpayment of the same.

However, although the Court is not at liberty to ignore the expressed freedom of FMLFC and NUMC to agree to such terms and conditions as they saw fit and convenient, the Court is nevertheless well within its powers to determine the real intention of the parties in their stipulations in the penalty clause, and to further make a finding as to whether said impositions are iniquitous or unconscionably redundant.

In *Filinvest Land Inc. v. Court of Appeals*,<sup>53</sup> the Court has held that by definition, a penal clause in a contract is an accessory undertaking to assume greater liability in case of breach, and is attached to an obligation in order to insure performance and serve a dual function: (1) to provide for liquidated damages, and (2) to strengthen the coercive force of the obligation by the threat of greater responsibility in the event of breach.<sup>54</sup> Article 1226 of the Civil Code states to this effect:

Art. 1226. In obligations with a penal clause, the **penalty shall substitute the indemnity for damages and the payment of interests in case of noncompliance**, if there is no stipulation to the contrary. Nevertheless, damages shall be paid if the obligor refuses to pay the penalty or is guilty of fraud in the fulfillment of the obligation.

The penalty may be enforced only when it is demandable in accordance with the provisions of this Code. (Emphasis supplied)

To be sure, the Court recognized the nuanced approach that must be taken when both liquidated damages and the penalty charge are imposed in the contract, as in the early case of *Laureano v. Kilayco*,<sup>55</sup> which instructed that a distinction between a penalty clause imposed essentially as penalty in case of breach and a penalty clause imposed as indemnity for damages should be made in cases where there has been neither partial nor irregular compliance with the terms of the contract.<sup>56</sup>

More specifically instructive is the case of *D.M. Ragasa Enterprises, Inc. v. Banco De Oro, Inc.*<sup>57</sup> (*D.M. Ragasa*), where the Court elaborated on the nature, source and purposes of a penalty under a contract in order to deduce the true nature of a penalty clause, viz.:

<sup>53</sup> G.R. No. 138980, September 20, 2005, 470 SCRA 260.

<sup>54</sup> Id. at 269.

<sup>55</sup> 32 Phil. 194 (1915).

<sup>56</sup> See id. at 200.

<sup>57</sup> G.R. No. 190512, June 20, 2018, 867 SCRA 71.



A penal clause is an accessory obligation which the parties attach to a principal obligation for the purpose of insuring the performance thereof by imposing on the debtor a special prestation (generally consisting in the payment of a sum of money) in case the obligation is not fulfilled or is irregularly or inadequately fulfilled. Quite common in lease contracts, this clause functions to strengthen the coercive force of the obligation and to provide, in effect, for what would be the liquidated damages resulting from a breach.

A penal clause has a three-fold purpose: (1) a coercive purpose or one of guarantee — this is to urge the debtor to the fulfillment of the main obligation under pain of paying the penalty; (2) to serve as liquidated damages — this is to evaluate in advance the damages that may be occasioned by the non-compliance of the obligation; and (3) a strictly penal purpose — this is to punish the debtor for non-fulfillment of the main obligation. While the first purpose is always present, the second purpose is presumed and the third purpose must be expressly agreed upon.

Stated otherwise, the purposes of penalty or penal clause are: (1) *funcion coercitiva o de garantia* or to insure the performance of the obligation; (2) *funcion liquidatoria* or to liquidate the amount of damages to be awarded to the injured party in case of breach of the principal obligation; and (3) *funcion estrictamente penal* or to punish the obligor in case of breach of the principal obligation, in certain exceptional cases. The second is evidently compensatory and the third is punitive in character, while the first is the general purpose regardless of whether the penalty is compensatory or punitive.

**Evidently, the penal clause may be considered either reparation, compensation or substitute for damages, on one hand, or as a punishment in case of breach of the obligation, on the other. When considered as reparation or compensation, the question as to the appropriate amount of damages is resolved once and for all because the stipulated indemnity represents a legitimate estimate made by the contracting parties of the damages caused by the nonfulfillment or breach of the obligation. Proof of actual damages is, consequently, not necessary in order that the stipulated penalty may be demanded.** When considered as a punishment, the question of damages is not yet resolved inasmuch as the right to damages, besides the penalty, still subsists. Thus, if the injured party desires to recover the damages actually suffered by him in addition to the penalty, he must prove such damages.

Penal clause may be classified into: (1) according to source: (a) legal (when it is provided by law) and (b) conventional (when it is provided for by stipulation of the parties); (2) according to demandability: (a) subsidiary (when only the penalty may be enforced) and (b) complementary (when both the principal obligation and the penalty may be enforced); and (3) according to purpose: (a) cumulative (when damages may be collected in addition to penalty) and (b) reparatory (when the penalty substitutes indemnity for damages).<sup>58</sup>

Within the framework of the Court's operative definition of a penalty clause as explained in *D.M. Ragasa*, but unlike the Court's appreciation in that case that the penal clause therein was punitive in nature, in this case, the

<sup>58</sup> Id. at 95-97. Emphasis supplied.

Court discerns as it so holds that the “late payment charge” clause in the Promissory Note in the instant case is not punitive, but compensatory, in that it serves the purpose of “*funcion liquidatoria* or to liquidate the amount of damages to be awarded to the injured party in case of breach of the principal obligation.”<sup>59</sup> To recall, the clause in the Promissory Note in the question provides:

Likewise, I/we hereby jointly and severally promise to pay a **late payment charge on any overdue sum under this note at the rate of five percent (5%) per month.**

It is further agreed that if upon such default, attorney’s services are availed of, an additional sum equal to twenty five percent (25%) of the total sum due thereon, x x x, shall be paid to the holder hereof for attorney’s fees plus an **additional sum equivalent to twenty five percent (25%) of the total sum due x x x, for liquidated damages** aside from expenses of collection and the legal costs provided in the Rules of Court.<sup>60</sup>

As may be gleaned from the above clause, and seen from the Court’s discussion of a penalty clause in *D.M. Ragasa*, although it clearly provides for the penalty charge at the rate of 5% *per* month as distinct from the imposition of the 25% liquidated damages, it nevertheless appears that the “late payment charge,” as stipulated, was imposed not as an addition to but *in lieu* of indemnity for damages and payment of interests in case of default in payment, as squarely described in Article 1226 of the Civil Code. Consistent with the operative definitions in *D.M. Ragasa*, the above-quoted “late payment charge” is clearly reparatory and thereby particularly stipulates the amount of compensatory damages to be paid by a defaulting party in case of breach.

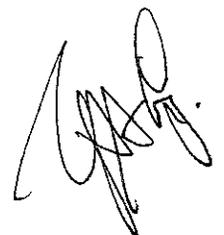
Since this indemnifying function is already what liquidated damages are for, and since the indemnification is already served by the imposition of the penalty of the “late payment charge,” the Court cannot now countenance the separate and simultaneous burdens of a penalty charge and liquidated damages on the part of the principal debtor or the surety, without agreeing to a carrying out of injustice by way of the unconscionable redundancy of penalties.

Furthermore, with respect to the amount of damages, the Court also reminds that since the penal clause is compensatory in purpose, the appropriate amount of damages is resolved without need of proof since the stipulated indemnity represents a legitimate estimate made by the parties of the damages caused by the breach. Once more on this point, the Court, in *D.M. Ragasa*, teaches:

As defined, liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof. The amount of the liquidated damages is purely contractual between the parties; and the courts will intervene only to equitably reduce the liquidated damages, whether

<sup>59</sup> Id. at 96.

<sup>60</sup> *Rollo*, p. 50. Emphasis supplied.



intended as an indemnity or a penalty, if they are iniquitous or unconscionable, pursuant to Articles 2227 and 1229 of the Civil Code.

**Also, proof of actual damages suffered by the creditor is not necessary in order that the penalty may be demanded.**<sup>61</sup>

The Court however notes that if under Article 1229 of the Civil Code,<sup>62</sup> it may reduce rates of interests and penalties which it discerns to be iniquitous, then with more reason can the Court remove redundant charges that serve the same end with respect to ensuring compliance of an undertaking under pains of costs.

The Court further reduces the stipulated attorney's fees for being unconscionable, for whether there is an agreement, the courts can fix a reasonable compensation which lawyers may receive for their professional services, as such falls within the regulatory prerogative of the courts.<sup>63</sup> On this score, Section 24, Rule 138 of the Rules of Court enables such reduction despite stipulation in cases of unconscionability, *viz.*:

*Sec. 24. Compensation of attorneys; agreement as to fees.* — An attorney shall be entitled to have and recover from his client no more than a reasonable compensation for his services, with a view to the importance of the subject-matter of the controversy, the extent of the services rendered, and professional standing of the attorney. No court shall be bound by the opinion of attorneys as expert witnesses as to the proper compensation but may disregard such testimony and base its conclusion on its professional knowledge. **A written contract for services shall control the amount to be paid therefor unless found by the court to be unconscionable or unreasonable.** (Emphasis supplied)

In determining the reasonableness of the attorney's fees that may be awarded in a given case, illustrative are the guideposts that the Court provided in *Rayos v. Hernandez*.<sup>64</sup>

Stipulated attorney's fees are unconscionable whenever the amount is by far so disproportionate compared to the value of the services rendered as to amount to fraud perpetrated upon the client. This means to say that the amount of the fee contracted for, standing alone and unexplained would be sufficient to show that an unfair advantage had been taken of the client, or that a legal fraud had been perpetrated on him.

The decree of unconscionability or unreasonableness of a stipulated amount in a contingent fee contract, will not, however, preclude recovery. It merely justifies the fixing by the court of a reasonable compensation for the lawyer's services.

Generally, the amount of attorney's fees due is that stipulated in the retainer agreement which is conclusive as to the amount of the lawyer's

<sup>61</sup> *Id.* at 97. Emphasis supplied.

<sup>62</sup> Article 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

<sup>63</sup> *Riguer v. Mateo*, 811 Phil. 538, 548 (2017).

<sup>64</sup> G.R. No. 169079, February 12, 2007, 515 SCRA 517.

compensation. **A stipulation on a lawyer's compensation in a written contract for professional services ordinarily controls the amount of fees that the contracting lawyer may be allowed, unless the court finds such stipulated amount unreasonable or unconscionable.** In the absence thereof, the amount of attorney's fees is fixed on the basis of *quantum meruit*, i.e., the reasonable worth of the attorney's services. Courts may ascertain also if the attorney's fees are found to be excessive, what is reasonable under the circumstances. In no case, however, must a lawyer be allowed to recover more than what is reasonable, pursuant to Section 24, Rule 138 of the Rules of Court.

We have identified the circumstances to be considered in determining the reasonableness of a claim for attorney's fees as follows: (1) the amount and character of the service rendered; (2) labor, time, and trouble involved; (3) the nature and importance of the litigation or business in which the services were rendered; (4) the responsibility imposed; (5) the amount of money or the value of the property affected by the controversy or involved in the employment; (6) the skill and experience called for in the performance of the services; (7) the professional character and social standing of the attorney; (8) the results secured; (9) whether the fee is absolute or contingent, it being recognized that an attorney may properly charge a much larger fee when it is contingent than when it is not; and (10) the financial capacity and economic status of the client have to be taken into account in fixing the reasonableness of the fee.<sup>65</sup>

Given the foregoing, the Court finds it fitting and so holds the further reduction of the attorney's fees as awarded, from 10% of the total outstanding obligation, to the amount of ₱100,000.00.

Finally, concerning the dismissal of the third-party complaint filed by Merrie Tan against Yao on the ground of failure to pay the docket fees, the Court is inclined to qualify said dismissal as one which must be without prejudice to a refile of the same, with the appropriate payment of legal fees. Apropos is the Court's counsel in the case of *Heirs of Reinoso, Sr. v. Court of Appeals*<sup>66</sup> (*Heirs of Reinoso, Sr.*) where the exceptions to the general rule of dismissal upon non-payment of docket fees were outlined, thus:

The rule is that payment in full of the docket fees within the prescribed period is mandatory. In *Manchester v. Court of Appeals*, it was held that a court acquires jurisdiction over any case only upon the payment of the prescribed docket fee. **The strict application of this rule was, however, relaxed two (2) years after in the case of *Sun Insurance Office, Ltd. v. Asuncion*, wherein the Court decreed that where the initiatory pleading is not accompanied by the payment of the docket fee, the court may allow payment of the fee within a reasonable period of time, but in no case beyond the applicable prescriptive or reglementary period.** This ruling was made on the premise that the **plaintiff had demonstrated his willingness to abide by the rules by paying the additional docket fees required.** Thus, in the more recent case of *United Overseas Bank v. Ros*, the Court explained that **where the party does not deliberately intend to defraud the court in payment of docket fees, and manifests its**

<sup>65</sup> Id. at 530-531.

<sup>66</sup> 669 Phil. 272 (2011).



**willingness to abide by the rules by paying additional docket fees when required by the court, the liberal doctrine enunciated in *Sun Insurance Office, Ltd.*, and not the strict regulations set in *Manchester*, will apply.** It has been on record that the Court, in several instances, allowed the relaxation of the rule on non-payment of docket fees in order to afford the parties the opportunity to fully ventilate their cases on the merits. In the case of *La Salette College v. Pilotin*, the Court stated:

Notwithstanding the mandatory nature of the requirement of payment of appellate docket fees, we also recognize that its strict application is qualified by the following: first, failure to pay those fees within the reglementary period allows only discretionary, not automatic, dismissal; second, such power should be used by the court in conjunction with its exercise of sound discretion in accordance with the tenets of justice and fair play, as well as with a great deal of circumspection in consideration of all attendant circumstances.

While there is a crying need to unclog court dockets on the one hand, there is, on the other, a greater demand for resolving genuine disputes fairly and equitably, for it is far better to dispose of a case on the merit which is a primordial end, rather than on a technicality that may result in injustice.<sup>67</sup>

In the instant case, the records show that at the level of the RTC, the third-party complaint of Merrie Tan against Yao was admitted in its Order dated June 6, 2007, and that Yao, for his part, filed his Compulsory Counterclaim thereto, without any mention of the non-payment of docket fees.<sup>68</sup> The records further show that Merrie Tan, *et al.* were only notified of their non-payment of docket fees through the assailed CA Decision, after which they immediately paid the filing fees to the Clerk of Court of the RTC, and thereafter submitted proof of such payment along with the Motion for Reconsideration they filed before the CA.<sup>69</sup>

It appears therefore that Merrie Tan's deportment upon notice of non-payment of the docket fees is one which falls squarely within the Court's description in *Heirs of Reinoso, Sr.* as one who has demonstrated willingness to abide by the rules and pay the necessary legal fees, and has otherwise shown no ill will or intent to defraud the court.

For this reason, the Court finds that it was an available option for the RTC to have simply accepted the docket fees that were belatedly paid and allowed the third-party complaint against Yao due course. Nevertheless, since it is evidently too late in the day to order a remand of the instant case solely for the purpose of giving due course to the third-party complaint against Yao which was already twice dismissed, the Court here discerns that the dismissal of said third-party complaint should have been made *without prejudice* to a refiling, in order to keep open the recourse of Merrie Tan against Yao as her co-surety. In this regard Merrie Tan can seek recourse with the appropriate

<sup>67</sup> Id. at 280-281. Citations omitted; emphasis supplied.

<sup>68</sup> *Rollo*, p. 27.

<sup>69</sup> Id. at 28.

RTC to seek a refund of the filing fees she had paid for the third-party complaint.

**WHEREFORE**, premises considered, the Petition is hereby **PARTLY GRANTED**.

The Decision dated October 30, 2019 and Resolution dated November 24, 2020 of the Court of Appeals in CA-G.R. CV No. 110069 are hereby **AFFIRMED** with **MODIFICATION**. New Unitedware Marketing Corporation, Merrie Anne L. Tan and Sing Jian Zi a.k.a. Samson Ding are **ORDERED** to jointly and severally **PAY** the First Malayan Leasing and Finance Corporation the following:

(1) Two Million Nine Hundred Forty-Two Thousand Eight Hundred Twenty-Two & Thirty-Six Centavos (₱2,942,822.36), subject to:

(a) the interest rate of twelve percent (12%) *per annum* from November 17, 2004 until June 30, 2013 and six percent (6%) *per annum* from July 1, 2013 until the finality of this Decision; and

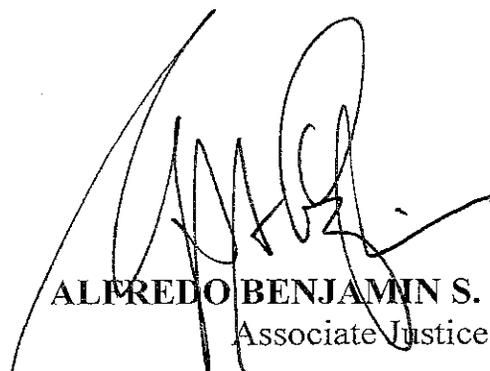
(b) the penalty charge of six percent (6%) *per annum* reckoned from November 14, 2004; and

(2) attorney's fees in the amount of ₱100,000.00.

The total judgment award shall be subject to interest at the rate of six percent (6%) *per annum* from the finality of this Decision until its full satisfaction.

Finally, the third-party complaint filed by Merrie Anne Tan and Willy Tan against Edward Yao is hereby **DISMISSED** without prejudice.

**SO ORDERED.**

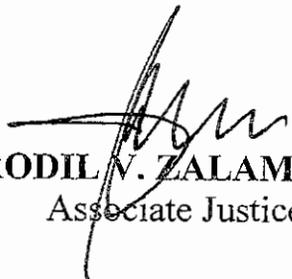


ALFREDO BENJAMIN S. CAGUIOA  
Associate Justice

WE CONCUR:

  
**ALEXANDER G. GESMUNDO**  
Chairperson  
Chief Justice

  
**ROSMARI D. CARANDANG**  
Associate Justice

  
**RODIL N. ZALAMEDA**  
Associate Justice

  
**SAMUEL H. GAERLAN**  
Associate Justice

**CERTIFICATION**

Pursuant to Section 13, Article VIII of the Constitution, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

  
**ALEXANDER G. GESMUNDO**  
Chief Justice

